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SUBJECT: PARAGUAY: INTERNATIONAL NARCOTICS CONTROL STRATEGY  
REPORT (INCSR) PART II: FINANCIAL CRIMES AND MONEY  
LAUNDERING

REF: STATE 210691

1. Paraguay is a principal money laundering center, involving both the banking and non-banking financial sectors. The multi-billion dollar contraband re-export trade that occurs largely on the border shared with Argentina and Brazil facilitates much of the money laundering in Paraguay. Paraguay is a major drug-transit country. The Government of Paraguay (GOP) suspects that proceeds from narcotics-trafficking are often laundered, but is it difficult to determine what percentage of laundered funds is directly generated from narcotics sales. Weak controls in the financial sector, an open border, and minimal enforcement activity for financial crimes allow money launderers and terrorist financiers to take advantage of Paraguay's financial system. Although the Government of Paraguay (GOP) has made some progress in 2005, it will need to pursue more aggressive policies in 2006 in order to increase its effectiveness in combating money laundering and terrorist financing.

2. Paraguay is particularly vulnerable to money laundering, as little personal background information is required to open a bank account or to make financial transactions in Paraguay. Paraguay is an attractive financial center for neighboring countries, particularly Brazil. Foreign banks are registered in Paraguay and nonresidents are allowed to hold bank accounts, but current regulations forbid banks from advertising or seeking deposits from outside the country. Paraguay is not considered to be an offshore financial center, but the GOP does allow representative offices of offshore banks to maintain a presence in the country. Shell companies are not permitted; trusts, however, are permitted and are regulated by the Central Bank. Nominee directors and/or trustees are not permitted. The Superintendent of Banks audits financial institutions and supervises all banks under the same rules and regulations. However, there are few effective controls over businesses, and a large informal economy exists outside the regulatory scope of the GOP.

3. Money laundering in Paraguay is facilitated by the multi-billion dollar contraband re-export trade that occurs largely in the Triborder Area shared by Paraguay, Argentina, and Brazil. Ciudad del Este (CDE), on the border between Brazil and Paraguay, represents the heart of Paraguay's informal economy. The area is well known for arms and narcotics-trafficking, as well as crimes against intellectual property rights. A wide variety of counterfeit goods, including cigarettes, CDs, DVDs, and computer software, are imported from Asia and transported primarily across the border into Brazil, with a significantly smaller amount remaining in Paraguay for sale in the local economy. Some senior government officials, including members of Congress, have been accused of involvement in the smuggling of contraband or pirated goods. To date there have been few criminal investigations, much less prosecutions of senior GOP officials involvement in smuggling contraband or pirated goods). Government officials, in both Paraguay and the United States, also suspect the area to be a source of terrorist financing. Raids in CDE have led to the seizure of extremist Islamic materials and receipts of wire transfers from Paraguay to the Middle East and the United States. Paraguay has taken some measures to tackle this "gray" economy and to implement reforms that promote a transition to a more formal, diversified economy.

4. In 2003, the GOP noted that it was trying to introduce "maquilas" (assembly line industries). In 2005, the maquila sector experienced rapid growth with 23 maquilas currently in operation. The largest maquila, a synthetic rubber factory, is Brazilian owned and located just outside of Ciudad del Este. The company has invested USD \$18 million into the project, one of the largest foreign investments into the Paraguayan economy. The GOP is trying to strengthen its tourism industry by improving its tourism infrastructure, including through efforts to make the international airport

in Asuncion a regional transportation hub for cargo and possibly passenger airlines. The new customs code implemented in early 2004 provided for the creation of formal free trade zones. One zone currently exists in Ciudad del Este and another is planned for the town of Villeta, near Asuncin. Paraguay's Customs organization is responsible for monitoring these zones, however there is little oversight. As a result, the addition of free trade zones may provide additional venues for money laundering.

15. There are no effective controls on the amount of currency that can be brought into or out of Paraguay. Cross-border reporting requirements are limited to those issued by airlines at the time of entry into Paraguay. Persons transporting USD \$10,000 into or out of Paraguay are required to file a customs report, but these reports are often not actually collected or checked. Customs operations at the airports or land ports of entry provide no control of the cross-border movement of cash. The non-bank financial sector, particularly exchange houses, are used to move illegal proceeds both from within and outside of Paraguay into the formal banking system of the United States. Most of these funds move from Brazil through Ciudad del Este to the banking sector. Paraguay exercises a dual monetary system in which most high-priced goods are paid for in U.S. dollars. Large sums of dollars generated from normal commercial activity and suspected illicit commercial activity are transported physically from Paraguay through Uruguay to the banking centers in the United States.

16. Bank fraud, which has led to several bank failures, and other financial crimes related to corruption are serious problems in Paraguay. Following bank failures in 2002 and 2003, Paraguay continues to experience problems in the banking industry. In 2004, Citibank decided to end its participation in small-consumer banking in Paraguay, and subsequently closed almost all of its branches nationwide. The GOP continues to work with the U.S. Treasury and Justice Departments to trace, account for, and return the missing USD \$16 million diverted from the Central Bank in 2002 to private accounts allegedly linked to the family of former President Luis Gonzalez Macchi.

17. Money laundering is a criminal offense under Paraguay's two anti-money laundering statutes, Law 1015 of 1996 and Article 196 of Paraguay's Criminal Code, adopted in 1997. The existence of the two laws has led to substantial confusion due to overlapping provisions. Under Article 196, the scope of predicate offenses includes only offenses that carry a maximum penalty of five years or more; Law 1015 includes additional offenses. Article 196 also establishes a maximum penalty of five years for money laundering offenses, while Law 1015 carries a prison term of two to ten years. This is particularly significant because, under the new Criminal Code and Criminal Procedure Code, defendants who accept charges that carry a maximum penalty of five years or less are automatically entitled to a suspended sentence and a fine instead of jail time, at least for the first offense. Since a defendant cannot be charged with money laundering unless he or she has first been convicted of the predicate offense, many judges are apparently reluctant to prosecute any defendant on money laundering charges because a sentence has already been issued for a predicate offense.

18. Law 1015 of 1996 also contains "due diligence" and "banker negligence" provisions and applies money laundering controls to non-banking financial institutions, such as exchange houses. Bank secrecy laws do not prevent banks and financial institutions from disclosing information to bank supervisors and law enforcement entities. Under Paraguay's Commercial Law 1023 and its anti-money laundering statute Law 1015 of 1996, banks are required to keep account records on hand for five years, but there is little government enforcement of this regulation. Additionally, bankers and others are protected under the anti-money laundering law with respect to their cooperation with law enforcement agencies.

19. Additional provisions of Law 1015 require banks and financial institutions to know and record the identity of customers engaging in significant currency transactions and to report those, as well as suspicious activities, to Paraguay's Financial Intelligence Unit (FIU), the Financial Analysis Unit (UAF). The UAF began operating in 1997 within the Secretary for the Prevention of Money Laundering (SEPRELAD), under the auspices of the Ministry of Industry and Commerce (MIC). However, for many years the UAF had been regarded as ineffective, and was hampered by a burdensome bureaucratic structure, lack of financial support, and the inability to keep trained personnel.

10. The UAF's weaknesses were reflected in the small number of cases presented to the Public Ministry (Attorney General's office) for prosecution. Before 2001, only one case went to trial, and it was dismissed on procedural grounds. The majority of the cases prepared by the UAF were incomplete and were returned to the UAF by prosecutors for more information

or investigation. Serious concerns also existed with regard to UAF,s personnel, its handling of confidential information, cumbersome record keeping, and concerns about possible corruption within the FIU. Efforts were made to by the GOP to improve its anti-money laundering capabilities, and in 2003, existing personnel began to be vetted and replaced as appropriate. U.S. law enforcement agencies and GOP entities have increased information sharing over the past year.

11. The banking "Risk Control Division," created in 2003 to replace the Superintendent of Banks, FIU, and eliminate its duplicative function with the UAF, has the primary responsibility of reviewing the records of national financial institutions for suspected terrorist activity. The Risk Control Division is empowered to coordinate information exchange with the Central Banks of other MERCOSUR countries, but has no authority to conduct investigative work associated with financial suspicious activity reports. That remains the purview of SEPRELAD,s Financial Analysis Unit. According to SEPRELAD officials, cooperation between the UAF and the Risk Control Division improved in 2005. In fact, the two groups signed a MOU in October 2005, laying out the provisions for increased cooperation. The MOU includes provisions for SEPRELAD to issue regulations for the banking industry, including the designation of a compliance officer, using "due-diligence," and exerting "know your customer" policies. The division currently is working on several important cases.

12. In 2005, SEPRELAD continued its efforts from 2004 to improve the FIU,s personnel, analytical capabilities, infrastructure, and technical capabilities. All FIU personnel are vetted and receive significant analytical training. Financial analysts received over 1000 suspicious activity reports in 2005 and are eager and willing to provide support to prosecutors and law enforcement agencies. Initially reluctant to seek SEPRELAD,s assistance, most government entities are increasingly prepared to work with SEPRELAD. SEPRELAD continues to seek information-sharing agreements with regional financial intelligence units, but has not secured any agreements with Brazil or Argentina to date. In 2005, the FIU sought to strengthen its relationship with other financial intelligence units following an unauthorized disclosure of U.S. financial information by the GOP in 2001. As a result information exchange between SEPRELAD and the U.S. FIU (FINCEN) was suspended. In March 2005 SEPRELAD re-established information sharing procedures with the U.S. Financial Intelligence Unit.

13. In 2005, SEPRELAD coordinated an interagency money laundering working group, whose members include the director of the FIU, the director of the National Anti-Drug Secretariat (SENAD), the assistant attorney general for

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economic crimes, the director of the customs agency and a criminal appellate judge. The FIU also increased its role in regional and international anti-money laundering groups, including the Egmont Group and the Financial Action Task Force for South America (GAFISUD). The FIU,s director now participates in the GAFISUD FIU Working Group and a committee within the Egmont Group, further expanding Paraguay,s role in these organizations. GAFISUD conducted its second mutual evaluation of Paraguay in September 2005. The results of the evaluation were shared during the organization's annual plenary session held December 13-15 in Buenos Aires. SEPRELAD officials believe that Paraguay will receive a positive review despite little progress towards the passage of a new anti-money laundering legislation in 2005.

14. The new law to improve the effectiveness of Paraguay,s anti-money laundering regime, drafted in late 2003, was formally introduced to Congress in May 2004, but it has not yet come up for formal consideration. Draft legislation on counterterrorism to address terrorist financing issues has not yet been introduced to Congress.

15. The new money laundering legislation, if approved, will institute important national reforms. In addition to confirming the SEPRELAD,s role as the sole FIU, it establishes SEPRELAD as an independent secretariat or agency reporting directly to the Office of the President. The draft law also establishes money laundering as an autonomous crime punishable by a prison term of five to 20 years. It establishes predicate offenses as any crimes that are punishable by a prison term exceeding six months, and specifically criminalizes money laundering tied to the financing of terrorist groups or acts. The full range of covered institutions will be required to report suspicious transactions to the FIU and to maintain registries of large currency transactions that equal or exceed \$10,000. Under the draft legislation, those institutions have been expanded to include, inter alia, banks; financial institutions; insurance agencies; currency exchange houses; securities companies and brokers (stock exchange); investment companies; money

transmitters; administrators of mutual investment and pension funds; credit unions; operators of gambling facilities; real estate agencies; nongovernmental organizations; pawnshops; and dealers in jewels, precious stones and metals, automobiles, art, and antiques. Other provisions of the draft law include penalties for failure to file or falsify reports, "know -your client provisions," and standardized record keeping for a minimum of seven years. The FIU will continue to refer cases as appropriate for further police (SENAD) investigation and to the Attorney General's Office for prosecution. It will also serve as the central entity for related information exchanges with other concerned foreign entities. The law further specifies that the investigative unit of SENAD is the principal authority for carrying out all counternarcotics and other financial investigations, and will also have the authority to initiate investigation of cases on its own.

¶16. There are other challenges, however, that the new money laundering legislation, when passed, will not address. With only eight positions for prosecutors dedicated to financial crimes of which six are currently filled, Paraguay currently has limited resources to investigate and prosecute money laundering and financial crimes. Moreover, prosecutors have little experience working with the FIU, and unless the new law is enacted, most judges have little incentive to investigate money laundering cases because many believe that sentencing on predicate offenses is sufficient punishment. Thus, there have not been any successful money laundering prosecutions in Paraguay so far, and improvement is unlikely until the new law becomes a reality. As it is, those individuals implicated in money laundering are prosecuted on tax evasion charges. In May 2004, Assad Barakat, widely alleged to be involved in money laundering, was convicted of tax evasion and sentenced to six and one-half years in prison. In late 2004, prosecutors begin investigating several tax evasion cases involving suspected money laundering by both legal and illegal money exchange offices in Ciudad del Este. A preliminary hearing is scheduled in December 2005, for Kassem Hijazi, who is suspected of having laundered proceeds from illicit activities in the tri-border area and sending a portion of those funds to support Lebanese Hizbollah activities.

¶17. Another serious problem for money laundering investigations that will not be corrected by the new law is the obligation of federal prosecutors to notify a suspect in writing that he/she is the subject of an investigation. Suspects must be notified within six months of the start of an investigation, and may have access to all information gathered through the investigation. This is mandated by Paraguay's penal code.

¶18. Under current laws, the GOP has limited authority to freeze, seize, and/or forfeit assets of suspected money launderers. In most cases, assets that the GOP is permitted to freeze, seize, and/or forfeit are limited to transport vehicles, such as planes and cars, and normally do not include bank accounts. However, authorities may not auction off these assets until a conviction is announced by the judicial system. At best, the GOP can establish a "preventative embargo" against assets of persons under investigation for a crime in which the state risks loss of revenue from furtherance of a criminal act, such as tax evasion. However, in those cases the limit of the embargo is set as the amount of liability of the suspect to the government. As the government entity primarily responsible for the tracing and seizing of assets, SENAD is required to split the proceeds of the forfeiture with the Public Ministry. SENAD currently has no figure for the amount of assets seized and/or forfeited in 2005, as it does not place a value on these assets before auction. Under current provisions of the law, significant legal loopholes exist, allowing criminals to hide their assets under another person's name.

¶19. The new anti-money laundering legislation will, when passed, allow prosecutors to recommend that judges freeze or confiscate assets connected to money laundering and its predicate offenses. The draft law also provides for the creation of a special asset forfeiture fund to be administered by a consortium of national governmental agencies, which will support programs for crime prevention and suppression, including combating money laundering, and related training.

¶20. The GOP currently has no authority to freeze, seize, and/or forfeit assets related to the financing of terrorism. A recent attempt to freeze the assets of a suspected terrorist financier for tax evasion failed because prosecutors perceived that the Paraguayan constitution prohibits the confiscation of personal property. The financing of terrorism is not criminalized under current Paraguayan law. However, the Ministry of Foreign Affairs often provides the Central Bank, SEPRELAD, and other government entities with a list of groups or individuals

included on the UNSCR 1267 Sanctions Committee consolidated list; to date, the GOP has not identified, seized, or forfeited any such assets linked to these groups or individuals. The current law also does not provide any measures for thwarting the misuse of charitable or non-profit entities that can be used as conduits for the financing of terrorism. Following the submission of the draft anti-money laundering law to Congress in May 2004, a working group of GOP and U.S. officials began drafting legislation to address terrorism and terrorist financing. The draft legislation will allow the GOP to conform to international standards on the suppression of terrorist financing. The draft anti-money laundering legislation will also specifically criminalize money laundering tied to the financing of terrorist groups or acts.

21. The GOP ratified the UN International Convention for the Suppression of the Financing of Terrorism in November 2004 and the Organization of American States Inter-American Convention on Terrorism in January 2005. Paraguay has also signed, but not ratified, the UN Convention against Corruption. In September 2004, the GOP ratified the UN Convention against Transnational Organized Crime. Paraguay is party to the 1988 UN Drug Convention, and participates in Summit of the Americas and Inter-American Drug Abuse Control Commission (CICAD)-related meetings on money laundering. Paraguay is a member of the South American Financial Action Task Force (GAFISUD), the Egmont Group, and the "3 Plus 1" Counter-Terrorism Dialogue between the United States and the Triborder Area countries.

22. While the Government of Paraguay took a number of positive steps in 2005, there are other initiatives that should be pursued in 2006 to increase the effectiveness of Paraguay's efforts to combat money laundering and terrorist financing. Most important is enactment of the new money laundering law that meets international standards. Uneven political support for the new money laundering law has hindered its passage in Congress. Paraguay also needs to continue efforts to combat corruption, and increase information sharing among concerned agencies when and if corruption issues are involved. Paraguay does not have a counterterrorism law or a law criminalizing terrorist financing. While the new money laundering law would increase the Government of Paraguay's abilities to combat terrorist financing, it should also take steps as quickly as possible to ensure that comprehensive counterterrorism legislation is passed. Reforms to the criminal procedure code that would allow prosecutors to carry out long-term criminal investigations are also needed. Reforms to the customs agency are also necessary in order to allow for increased inspections and interdictions at ports of entry and to develop strategies targeting the physical movement of bulk cash. It is essential that SEPRELAD's Financial Analysis Unit continue to receive the financial and human resources necessary to operate as an effective, fully functioning financial intelligence unit capable of effectively combating money laundering, terrorist financing, and other financial crimes.

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